François Villeroy de Galhau: Two insights concerning the latest developments in price stability and financial stability

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the 2024 Eurofi Financial Forum, Budapest, 13 September 2024.

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Ladies and Gentlemen,

I first want to thank warmly David Wright and Didier Cahen for organising once more this impressive Eurofi event, this time in the wonderful city of Budapest, and for exceptionally allowing me to speak remotely. I would like to share with you briefly some insights into two current developments: our monetary policy decision yesterday, and the latest US revision on Basel 3.

I. An obvious but important monetary policy decision

We decided yesterday a second rate cut. Our Governing Council led by Christine Lagarde took a unanimous decision, because the economic evidence was strong. **Inflation** evolves according to our forecast, which we didn't change in any decimal (the first time since almost 20 quarters): we are at 2.2 % in August, and we should reach a lasting 2% by the second half of next year. Furthermore, market expectations on inflation – be it on fixing or in the options market – are at present significantly below our own forecast, but time will tell.

On **activity**, the latest data have been somewhat disappointing, with growth stemming mainly from net exports and government consumption, while private domestic demand weakened. High uncertainty and low confidence still foster savings, rather than households' consumption and firms' investment. By the way, Banque de France will publish its forecast for France on September 17th, and beyond the one-off stimulus of the successful Olympic games, it will be consistent with this view of a very gradual recovery.

Hence, our decision also proceeds from a sound risk management. Unlike the US, we don't have a *dual* mandate (prices / employment), but we have clearly a *symmetric* mandate around our 2% target: we must be attentive to the risk of undershooting our target as much as to the risk of overshooting it.

It was not our first rate cut, and it will not be the last one. Hence the frequent question: what will come next? Well, we said clearly that we will decide meeting by meeting, and be data-driven – beyond the possible volatility of the next monthly figures and including leading indicators. To put it in other words: the direction of the journey is clear – we should continue to reduce gradually and as appropriate the degree of restriction of our monetary policy. But the pace has to be highly pragmatic: we are not pre-committing to any particular rate path, and we keep our full optionality for our next meetings. Be assured anyway of our firm determination, and even commitment, to bring inflation sustainably back to 2% during next year. Let me add one thing: Europeans shouldn't rely exclusively on monetary policy to address their serious growth challenge : hence our clear call yesterday not to bury Mario Draghi's and Enrico Letta' s reports and their proposals of badly needed supply side reforms – which are not fiscally costly for many of them.

II. On Basel 3, a gradual US clarification

Let me first welcome the clarifications brought earlier this week by Fed's Vice Chair M. Barr regarding the US revised Basel endgame proposal and, more importantly, their restated commitment to implementing the Basel 3 package. It is a good omen for financial stability.

Nevertheless, we don't have yet the precise content, as it remains to be adopted by the three federal agencies. The initial US proposal, published in July 2023, contained indeed some provisions that were gold plating the Basel rules. These provisions are expected to be largely and legitimately eliminated in this new version. That being said, the Basel Committee will be paying careful attention to the precise rules to come. On certain areas of risks, especially on market and operational risks, and some of the directions recently announced as a "preview" of the final reform, it will have to be looked at whether they might possibly deviate from the Basel standards. The scope of application of the revised rules could be an additional focus, in particular for medium-sized banks with balance sheets of between USD 100 and 250 billion.

Finally, the timeline must be clarified quickly, to reduce as much as possible the time gap between major jurisdictions: this also regards the UK. As you all know, in the European Union, the rules stemming from Basel 3 will start to apply as of January 2025, but with one important and warranted adaptation: the Commission's proposal to postpone to January 2026 the implementation of the FRTB (Fundamental Review of the Trading Book) on market risks.

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The two topics I just dealt with have some links, indeed: our duty as central banks is to restore price stability while preserving financial stability. Achieving these two objectives together was not expected to be easy, remember the fears till early 2023; but we have been successful so far, and not by chance as banks are now safer thanks to Basel. European banks are also very sensitive to competitiveness, and rightly so: but safety and competitiveness are not at odds, on the contrary. Be sure we will now be more and more attentive to ensure their compatibility. Thank you for your attention.